Dear Ms. Murphy:

We are submitting this comment letter in response to the October 17, 2012 Notice of Proposed Rulemaking on Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, issued by the Securities and Exchange Commission (the “SEC”). We appreciate the opportunity to comment on the proposed requirements set forth in the Notice of Proposed Rulemaking, pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

This comment letter is submitted on behalf of KfW, and the views expressed herein are those of KfW only. For the reasons described herein, we believe that the use of Swaps, as defined under Dodd-Frank, by KfW, which, as explained below, is a foreign government-linked entity owned by the Federal Republic of Germany (the “Federal Republic”) and the German states and the obligations of which are backed by the full faith and credit of the Federal Republic due to a statutory guarantee, should not be subject to the regulatory scheme imposed by Dodd-Frank. Accordingly, we respectfully request that the SEC use the authority provided by Dodd-Frank to exclude any agreement, contract or transaction a counterparty of which is KfW from the requirement to post collateral to cover both current exposure and potential future exposure.
I. Background on KfW

Legal Status, Ownership and Statutory Guarantee

KfW is a German public law institution (Anstalt des öffentlichen Rechts) organized under the Law Concerning KfW (Gesetz über die Kreditanstalt für Wiederaufbau, or “KfW Law”). The Federal Republic holds 80% of KfW’s equity capital and the German federal states hold the remaining 20%.

The KfW Law expressly provides that the Federal Republic guarantees all existing and future obligations of KfW in respect of money borrowed, bonds and notes issued and derivative transactions entered into by KfW (KfW Law, Article 1a). Under this statutory guarantee (the “Guarantee of the Federal Republic”), if KfW fails to make any payment of principal or interest or any other amount required to be paid with respect to any of KfW’s obligations mentioned in the preceding sentence, the Federal Republic will be liable at all times for that payment as and when it becomes due and payable. The Federal Republic’s obligation under the Guarantee of the Federal Republic ranks equally, without any preference, with all of its other present and future unsecured and unsubordinated indebtedness. Creditors who have a claim against KfW resulting from one of the obligations mentioned in the first sentence of this paragraph may enforce this obligation directly against the Federal Republic without first having to take legal action against KfW. Against this background, these obligations of KfW, both financially and in terms of legal recourse, are viewed as sovereign credits and KfW, like the Federal Republic, enjoys a triple A credit rating.

Furthermore, as a public law institution, KfW benefits from the German administrative law principle of Anstaltslast, according to which the Federal Republic, as the constituting body of KfW, has an obligation to safeguard KfW’s economic basis. Under Anstaltslast, the Federal Republic must keep KfW in a position to pursue its operations and enable it, in the event of financial difficulties, through the allocation of funds or in some other appropriate manner, to meet its obligations when due. Although Anstaltslast is not a formal guarantee of KfW’s obligations by the Federal Republic, the effect of this legal principle is that KfW’s obligations are fully backed by the credit of the Federal Republic on this basis as well, in addition to the Guarantee of the Federal Republic referred to above.

Purpose

KfW was established in 1948 by the Administration of the Combined Economic Area, the immediate predecessor of the Federal Republic. Originally, KfW’s purpose was to distribute and lend funds of the European Recovery Program (the “ERP”), which is also known as the Marshall Plan. Even today, several of KfW’s programs to promote the German and
European economies are supported using funds for subsidizing interest rates from the so-called “ERP Special Fund”. Over the past decades, KfW has expanded and internationalized its operations. Today, KfW serves domestic and international public policy objectives of the German Federal government, primarily by engaging in various promotional lending activities.¹

As a government-owned entity, KfW does not seek to maximize profits and is prohibited from distributing profits, which are instead allocated to statutory and special reserves.² KfW is also prohibited from taking deposits, conducting current account business or dealing in securities for the account of others.

Governance and Supervision

KfW is governed by an Executive Board (Vorstand) and a Board of Supervisory Directors (Verwaltungsrat). The Executive Board is responsible for the day-to-day conduct of KfW’s business and the administration of its assets. The Board of Supervisory Directors, which, among others, consists of seven Federal ministers³, supervises the overall conduct of KfW’s business and the administration of its assets.

¹ KfW’s lending activities include: domestic financing, primarily made through commercial banks, including loans to small and medium-sized enterprises, housing-related loans, grants and financings to individuals for educational purposes, financing for infrastructure projects and global funding instruments for promotional institutes of the German federal states (Landesförderinstitute); export and project finance through its wholly-owned subsidiary KfW IPEX-Bank GmbH (“KfW IPEX-Bank”); and development finance for developing and transition countries, including private-sector investments in developing countries through its wholly-owned subsidiary DEG—Deutsche Investitions- und Entwicklungsgesellschaft mbH (“DEG”).

² On November 4, 2012, the committee of the German governing coalition agreed to revoke the prohibition on profit distribution by KfW, which is stipulated in the KfW Law. According to a press release of the committee of the German governing coalition, the prohibition on profit distribution shall be lifted with effect for profit generated, if any, in the 2013 fiscal year. Profits shall be kept by KfW to the extent necessary for an adequate capitalization. Any remainder shall be distributed to KfW’s shareholders in proportion to their respective stakes. KfW is currently unable to predict whether and, if so, when or in what form such plans may be realized or any amendments to the KfW Law may be implemented.

³ Generally, the Supervisory Board has 37 members and consists of the Federal Minister of Finance; the Federal Minister of Economics and Technology; the Federal Minister of Foreign Affairs; the Federal Minister of Food, Agriculture and Consumer Protection; the Federal Minister of Transport, Building and Urban Affairs; the Federal Minister for Economic Cooperation and Development; the Federal Minister for the Environment, Nature Conservation and Nuclear Safety; seven members appointed by the Bundesrat; seven members appointed by the Bundestag; five representatives of commercial banks; two representatives of industry; one representative each of the local municipalities, agriculture, crafts, trade and the housing industry; and four representatives of the trade unions. The representatives of the commercial banks, industry, the local municipalities, agriculture, crafts, trade, the housing industry and the trade unions are appointed by the German Federal government after consultation with their constituencies.
Under the KfW Law, the Federal Ministry of Finance, in consultation with the Federal Ministry of Economics and Technology, supervises KfW and has the power to adopt all measures necessary to safeguard the compliance of KfW's business operations with applicable laws, KfW's by-laws and other regulations.

In addition to the annual audit of its financial statements, KfW, as a government-owned entity, is subject to an audit that meets the requirements of the German Budgeting and Accounting Act (Haushaltsgrundsätzegegesetz). One of the specific aspects to be covered by this audit and the related reporting is the proper conduct of KfW's business by its management.

**Funding Activities and Derivatives Transactions**

KfW finances the majority of its lending activities from funds raised by it in the international financial markets. KfW issues debt instruments in various currencies, primarily the Euro and the U.S. dollar (which accounted for 50% and 29% of KfW's new capital-market funding in 2011, respectively). As of December 31, 2011 KfW's total outstanding funded debt amounted to EUR 365.0 billion. On the basis of a no-action letter issued by the SEC on September 21, 1987, KfW, in connection with global debt offerings in an aggregate amount equivalent to close to EUR 350 billion, has registered debt securities with the SEC under Schedule B of the Securities Act of 1933, which is applicable to foreign governments or political subdivisions thereof, and more than 50% of KfW's funded debt outstanding on December 31, 2011 consisted of debt securities sold in these global debt offerings.

KfW enters into derivatives transactions in order to manage the risks incurred by it and its wholly-owned subsidiaries KfW IPEX-Bank and DEG in connection with its financing and funding activities. Such risks are almost entirely associated with changes in interest rates and foreign exchange rates. While KfW occasionally entered into single-name credit default swaps in the past in order to hedge credit risk incurred in connection with its financing activities, there are no such transactions outstanding as of the date hereof. However, at some point in the future, KfW may enter into single-name credit default swaps for hedging credit risk again, as well as enter into equity-related security-based swaps for purposes of hedging equity risk related to the issuance of notes which pay-out may be linked to the performance of a single stock or a narrow basket or index of stocks. Many of KfW's counterparties are dealers based in the United States. As of December 31, 2011, the total notional amount of derivatives outstanding amounted to EUR 713 billion equivalent (on a consolidated basis), of which close to 25% (by notional amount) were executed with U.S. counterparties (including non-U.S. affiliates of U.S. counterparties).
KfW enters into all of the foregoing types of transactions solely for purposes of hedging risks incurred by it and its wholly-owned subsidiaries KfW IPEX-Bank and DEG, and KfW does not and, in accordance with Article 2 paragraph 3 of the KfW Law, may not, engage in proprietary or speculative trading. Further, KfW does not accommodate demand for swaps from other parties nor enter into swaps in response to interest expressed by other parties in the manner a dealer would customarily do, except that, in the context of centralizing and aggregating market-facing hedging activities within the group at the parent level, KfW accommodates demand for swaps by its wholly-owned subsidiaries KfW IPEX-Bank and DEG for their hedging activities. KfW therefore considers itself as an end-user customer of derivatives.

All of KfW’s OTC derivatives transactions are concluded under appropriate derivatives master agreements (such as the ISDA Master Agreement and the German Master Agreement for Financial Derivatives Transactions). As part of KfW’s risk policy, KfW’s exposures under such derivatives master agreements generally are to be collateralized by KfW’s counterparties. While KfW receives collateral from its counterparties under credit support annexes pertaining to the respective derivatives master agreement, it generally does not provide collateral itself for purposes of mitigating credit risk, because, as mentioned above, its obligations are backed by the Guarantee of the Federal Republic. Internal guidelines require that no transaction is executed outside such (collateralized) derivatives master agreements.

II. Treatment of Foreign Governments and KfW under certain Final and Proposed Rules issued by the CFTC under Title VII of Dodd-Frank

In the release accompanying its proposed rules the SEC stated that it consulted with the CFTC and the Prudential Regulators on the proposed rules, but that the potential international implications of the proposed margin rules warrant further consideration and that the SEC intends to publish a comprehensive release relating to cross-border issues. Keeping in mind the SEC’s intention, we would like to respectfully point out the manner in which the CFTC and Prudential Regulators have responded to entities such as KfW and foreign entities in general. In the CFTC’s release accompanying its final rules regarding the further definition of “Swap Dealer” (“SD”), “Major Swap Participant” (“MSP”), and other matters, the CFTC stated that foreign governments, foreign central banks and international financial institutions should not be required to register as SDs or MSPs and it clarified that it considers KfW a foreign government for this purpose.4

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4 See CFTC and the Securities and Exchange Commission, Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major
Furthermore, in its release accompanying its final rules regarding the end-user exception to clearing requirements for Swaps, the CFTC similarly stated that foreign governments, foreign central banks and international financial institutions will not be subject to the requirement under Dodd-Frank that Swap transactions be cleared through a derivatives clearing organization and it also clarified that it considers KfW a foreign government for this purpose.\(^5\)

The CFTC has therefore recognized that foreign sovereign entities in particular should be distinguished from other non-U.S. persons and excluded from certain of the most significant regulatory requirements and that KfW should be treated as a sovereign for these purposes. In so doing, the CFTC stated that “[c]anons of statutory construction assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws” and acknowledged that “[t]here is nothing in the text or history of the swap-related provisions of Title VII to establish that Congress intended to deviate from the traditions of the international system by including foreign governments, foreign central banks and international financial institutions within the definitions of the terms “swap dealer” or “major swap participant,” thereby requiring that they affirmatively register as swap dealers or major swap participants with the CFTC and be regulated as such.” Similarly, the CFTC acknowledged that “[t]here is nothing in the text or history of the swap-related provisions of Title VII to establish that Congress intended to deviate from the traditions of the international system by subjecting foreign governments, foreign central banks and international financial institutions to the clearing requirement set forth in Section 2(h)(1) of the CEA.”

Security-Based Swap Participant” and “Eligible Contract Participant,” 77 Fed. Reg., 30,596, 30,692-93 (May 23, 2012). The CFTC stated that it “does not believe that foreign governments, foreign central banks and international financial institutions should be required to register as swap dealers or major swap participants.” See id. at 36,093. In addition, in a footnote just prior to that statement, the Release stated that “[f]or this purpose, we consider that the term “foreign government” includes KfW, which is a non-profit, public sector entity responsible to and owned by the federal and state authorities in Germany, mandated to serve a public purpose, and backed by an explicit, full, statutory guarantee provided by the German federal government.” See id. at fn. 1178.

\(^5\) See CFTC, End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012). The CFTC stated that “foreign governments, foreign central banks, and international financial institutions should not be subject to the [clearing] requirements of Section 2(h)(1) of the CEA.” See id. at 42,562. It further stated, as it did in its release with respect to the swap dealer and MSP definition rules, that “for this purpose, the Commission considers that the term “foreign government” includes KfW, which is a non-profit, public sector entity responsible to and owned by the federal and state authorities in Germany, mandated to serve a public purpose, and backed by an explicit, full statutory guarantee provided by the German federal government.” See id. fn 12 at 42,561.
In light of the arguments brought forward by the CFTC as quoted in the preceding paragraphs, we believe that the CFTC should come to the same conclusion concerning the treatment of foreign governments (including KfW) with respect to the CFTC's proposed margin rules and have thus respectfully requested the CFTC to provide similar guidance on the treatment of foreign governments (including KfW) in the release to its final margin rules, or provide appropriate other relief to the same effect, by submitting a comment letter dated September 7, 2012.

We further believe that the provisions in the SEC's margin rules, taken together with the CFTC's statements and reasoning in the releases accompanying the final definitions of SDs and MSPs and its final rules applicable to end-users, similarly warrant excluding foreign governments (including KfW) from the requirement to post collateral under the SEC's rules for the very reasons stated in these releases as quoted above. Accordingly, we respectfully request that the SEC determine that foreign governments (including KfW) be excluded from the requirement to post collateral for both current exposure and potential future exposure in its finalization of the proposed rules.

III. Exception from the Proposed Margin Requirements for Entities Such as KfW

If the SEC's regulations requiring collateral to be posted for current exposure and future potential exposure in connection with Security-Based Swaps not cleared through a registered clearing agency are adopted as currently proposed, KfW could be required to post collateral in connection with its Security-Based Swaps transactions if its counterparties are registered Security-Based Swap Dealers ("SBSD") or Major Security-Based Swap Participants ("MSBSP"), notwithstanding KfW's limited purpose in entering into Security-Based Swaps as outlined under I. above and despite the fact that it is backed by the full faith and credit of the Federal Republic. We do not believe that this result is warranted or appropriate, or that it will operate to reduce systemic risk or to protect market participants. To the contrary, it will serve only to increase the cost, and reduce the efficiency, of necessary hedging transactions entered into by KfW, and perhaps force it to transact primarily or exclusively with non-U.S. counterparties.

In light of the significant losses incurred during the financial crisis, particularly in connection with uncleared Security-Based Swaps, Dodd-Frank amended the Securities Exchange Act of 1934 (the "Exchange Act") to account for the need to address the added risk posed by Security-Based Swaps that are not cleared through a clearing house. Section 15F(e)(3)(A) of the Exchange Act addresses the need to offset the greater risk from uncleared Security-Based Swaps posed to SBSDs and MSBSPs, and the financial system more broadly, and directs the SEC to adopt requirements
that (i) "help ensure the safety and soundness of the security-based swap dealer or major security-based swap participant" and (ii) "be appropriate for the risk associated with the non-cleared security-based swaps held as a security-based swap dealer or major security-based swap participant."

While we support the SEC’s measures to enhance the safety and soundness of, and reduce systemic risk to, the overall financial system, the proposed establishment of margin requirements for uncleared Security-Based Swaps was prompted by the failure of profit-maximizing commercial institutions. As a not-for-profit public entity backed by the full faith and credit of the Federal Republic, KfW does not pose the type of risk to counterparties, both U.S. and non-U.S., and the wider financial system that the proposed margin requirements seek to rectify.

The Dodd-Frank amendments to the Exchange Act required that the regulations adopted by the SEC to address the risk caused by uncleared Security-Based Swaps be “appropriate” for the actual risk posed. Requiring entities such as KfW to post collateral on their Security-Based Swap transactions would neither be “appropriate” nor be necessary to mitigate the type of risk that the proposed margin requirements seek to rectify. An exemption from the margin requirements on uncleared Security-Based Swaps would not be inconsistent with the principles guiding the SEC’s rulemaking and would avoid placing an unnecessary burden on KfW.

Therefore, we respectfully submit that entities such as KfW, which are not-for-profit public entities backed by the full faith and credit of a sovereign government, should not be required to post collateral on Security-Based Swaps transactions not cleared through a registered clearing agency.

IV. Basel Committee on Banking Supervision ("BCBS") and International Organization of Securities Commissions ("IOSCO") Working Group on Margin Requirements (the "WGMR") and Request for Relief

The CFTC and the Prudential Regulators reopened the comment period for the proposed rules on margin in order to provide interested parties an opportunity to comment concurrently on the WGMR Consultative Document on Margin Requirements for Non-Centrally-Cleared Derivatives (the "WGMR Paper") issued in July 2012 and on the proposed rules. In this regard, we note that the WGMR Paper provides that "BCBS and IOSCO broadly supported not applying the margin requirements in a way that would require sovereigns or central banks to either collect or post margin. Both of these views are reflected by the effective exclusion of such transactions from the scope of the margin requirements proposed in this consultative paper."
Based on these statements, we expect the WGMR to exclude sovereigns and sovereign-linked entities from the scope of the margin requirements in their final recommendations.

Also, the WGMR Paper in Key Principle 7 provides that "[r]egulatory regimes should interact so as to result in sufficiently consistent and non-duplicative regulatory margin requirements for non-centrally cleared derivatives across jurisdictions."7 In this context, we note that Article 1 Paragraph 4 and 5 of the so-called European Market Infrastructure Regulation ("EMIR")8 provides for both an exemption from the clearing obligation for standardized derivatives in accordance with Article 4 of EMIR and from certain risk mitigation techniques (including but not limited to "exchanging collateral", i.e. posting and collecting margin) in accordance with Article 11 of EMIR for sovereigns, central banks, multilateral development banks and government-guaranteed public sector entities. KfW is a public sector entity within the meaning of Article 1 Paragraph 5b) of EMIR, and is thus not subject to the clearing obligation nor the margin requirements under EMIR.

We believe that excluding entities such as KfW from the requirement to post collateral is consistent with the approach taken in the WGMR Paper with respect to margin requirements for non-centrally cleared derivatives. Further, taking into consideration the exception for government-guaranteed public sector entities from the margin requirements under EMIR, such exclusion would also be consistent with Key Principle 7 of the WGMR paper calling for consistent regulatory margin requirements for non-centrally cleared derivatives across jurisdictions and be responsive to Section 752(a) of Dodd-Frank that requires the SEC to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation ... of swaps ..." Accordingly, we respectfully request that the SEC confirm the exclusion of government entities (including KfW) also for the reasons presented in this section in its finalization of the proposed rules.


7 id. at 29.

V. Conclusion

There is no evidence suggesting that Congress intended government-owned entities like KfW to be subject to Title VII of Dodd-Frank. KfW’s derivatives transactions did not contribute to the recent financial crisis that resulted in the adoption of Dodd-Frank. Subjecting KfW and its derivative transactions to the margin requirements of Dodd-Frank could have serious adverse effects on its ability to cost-efficiently hedge the risks to which it is exposed, thereby increasing costs to its borrowers, and thus may force it to direct hedging transactions currently still concluded with U.S. counterparties to non-U.S. counterparties in the future. Moreover, imposing the margin requirements of Dodd-Frank on KfW and its derivative transactions is unnecessary for the protection of counterparties and the financial system. Finally, an exclusion for KfW from the requirement to post collateral would be in line with KfW’s treatment in respect of margin requirements under EMIR, be consistent with the expected scope of the WGMR paper and adequately take into account the objective to achieve consistent international regulatory requirements in accordance with Key Principle 7 of the WGMR paper and Section 752(a) of Dodd-Frank.

Accordingly, for the reasons set forth above, KfW should not be subject to the SEC’s proposed margin regulations and, we respectfully submit, should be eligible for the relief described above.

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Thank you for your consideration of our comments and please do not hesitate to contact David J. Gilberg of Sullivan & Cromwell LLP at 212-558-4000 or gilbergd@sullcrom.com if you have questions or would find further background helpful. We have sent a copy of this letter to the Federal Ministry of Finance of Germany in its capacity as KfW’s supervisory authority.

Sincerely,

KfW

Name: Dr. Lutz-Christian Funke
Title: Senior Vice President

Name: Dr. Frank Czichowski
Title: Senior Vice President and Treasurer